

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 247 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed
to see the judgements? Yes

2. To be referred to the Reporter or not? Yes

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3. Whether Their Lordships wish to see the fair copy
of the judgement? No

4. Whether this case involves a substantial question
of law as to the interpretation of the Constitution
of India, 1950 of any Order made thereunder? No

5. Whether it is to be circulated to the Civil Judge?
No

COMMISSIONER OF INCOME TAX

Versus

NAVJIVAN ROLLER & PULES MILLS

Appearance:

MR MANISH R BHATT for Petitioner
NOTICE SERVED for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and

MR.JUSTICE A.R.DAVE

Date of decision: 03/05/99

ORAL JUDGEMENT (per R. Balia, J.)

On an application made by the Commissioner of Income-tax, Baroda in this behalf, following question of law arising out of Tribunal's order in I.T.A. No. 2001 & 2002/Ahd/82 dated 14.10.83 are referred to this Court by the Income Tax Appellate Tribunal, Ahmedabad Bench 'B' for the opinion of this Court:-

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the various accounts on which interest of Rs. 31,886 and Rs. 47176 is paid fall outside the purview of Explanation (b) to Sec. 40A(8)?"

2. The two appeals related to two different Assessment Years 1978-79 and 1979-80 respectively. During the the previous year relevant to the assessment years the assessee company has paid interest of Rs. 5,02,087 and Rs. 5,27,418 respectively. Out of these amounts, Rs. 31,886 and Rs. 47176 for the respective years has been paid to directors, shareholders and others. This amount, according to the Assessing Officer, required to be considered u/s 40A(8) of the Income-tax Act, 1961 as interest paid on deposits and deduction on that account were liable to be reduced by 15% of the sum. He therefore reduced the allowable expenditure relating to aforesaid two amounts by 15% by applying Sec. 40A(8) of the Income-tax Act. The CIT (Appeals) found that the credit balances in the current accounts cannot be termed even as money borrowed, they are certainly not deposits as such. The deposits can be received by company or can be given by the depositor and obviously there would be consciousness on the part of either or both regarding the money in question being kept as deposit for some foreseeable period and generally deposits are in round figures. Similarly, moneys can be borrowed by a company and they also may be for specified or unspecified periods, but consciousness of borrowing the same would be existing. In contradiction to deposits and borrowings, credit balances in current accounts are kept for being withdrawn at any time. The credit balances in current accounts are left by the account holders just like that for being withdrawn by them for their own purpose at their own will at any time. So the concept of deposit or

borrowing is different from that of the credit balance kept in current accounts. This distinction is very specifically observed by the banks which accept deposits of different duration and under different schemes like recurring deposit scheme etc. On the other hand, these banks maintain current accounts and savings bank accounts as well. The basic distinction applicable in the case of bank applies to that of a company also particularly where the deposit accounts are separately kept in the names of those very persons whose current accounts are also maintained.

3. On this finding CIT (Appeals) held that sec. 43B is not applicable because the credit balance in current accounts are not deposits or borrowings within the meaning of sec. 40A(8). On appeal, Income Tax Appellate Tribunal affirmed the finding of the CIT (Appeals) approving its reasons. In doing so, it followed another decision of the Tribunal in ITA Nos. 444 to 446/Madras/1981 dated 19.2.1982.

4. Thus, we find that the credit balances standing in the name of directors, shareholders or other persons on which interest was paid by the company were held not to be deposit because of the following characteristics:

- (i) deposits must be for some foreseeable period,
- (ii) generally deposits must be in round figures,
- (iii) consciousness on the part of the depositor or the borrower as to the nature of transaction must exist,
- (iv) that current account facility permitted the account holder to withdraw money as and when he likes is contrary to the character of deposit, and last but not least
- (v) the current account which is a characteristic of holding accounts with the bank is treated differently from the deposits and advances by the bankers and the same principle applies to the company as well, if the accounts are kept in like manner.

5. Before embarking on further analysis about the correctness of this conclusion, it would be appropriate to notice the provisions of law which concerns the issue before us.

"Sec. 40A(8)

Sub-section (8) has since been omitted by the Finance Act, 1985, w.e.f. 1.4.1986. During the

Assessment Years in question 1978-79 and 1979-80 sub-section (8) of Sec. 40A, as inserted by the Finance Act, 1975, w.e.f. 1.4.1976, stood as under:

(8) Where the assessee, being a company (other than a banking company or a financial company), incurs any expenditure by way of interest in respect of any deposit received by it, fifteen per cent of such expenditure shall not be allowed as a deduction.

Explanation. - In this sub-section, -

(a) "banking company" means a company to which the Banking Regulation Act, 1949 (10 of 1949), applies and includes any bank or banking institution referred to in section 51 of that Act;

(b) "deposit" means any deposit of money with, and includes any money borrowed by, a company, but does not include any amount received by the company -

(i) from the Central Government or any State Government or any local authority, or from any other source where the repayment of the amount is guaranteed by the Central Government or a State Government;

(ii) from the Government of a foreign State, or from a citizen of a foreign State, or from any institution, association or body (whether incorporated or not) established outside India;

(iii) as a loan from a banking company or from a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank;

(iv) as a loan from any institution or body specified in the list in the Tenth Schedule or such other institution or body as the Central Government may, having regard to the nature and objects of the institution or body, by notification in the Official Gazette, specify in this behalf;

(v) from any other company;

(vi) from an employee of the company by way of security deposit;

(vii) by way of security or as an advance from any purchasing agent, selling agent or other agent in the course of, or for the purpose of, the business of the company or as advance against orders for the supply of goods or for the rendering of any service;

(viii) by way of subscription to any share, stock, bond or debenture (such bond or debenture being secured by a charge or a lien on the assets of the company) pending the allotment of the said share, stock, bond or debenture, or by way of advance payment of any moneys uncalled and unpaid upon any shares in the company, if such moneys are not repayable in accordance with the articles of association of the company;

(iv) as a loan from any person where the loan is secured by the creation of a mortgage, charge or pledge of any assets of the company (such loan being hereafter in this sub-clause referred to as the relevant loan) and the amount of the relevant loan, together with the amount of any other prior debt or loan secured by the creation of a mortgage, charge or pledge of such assets, is not more than seventy-five per cent of the price that such assets would ordinarily fetch on sale in the open market on the date of creation of the mortgage, charge or pledge for the relevant loan;

(c) "financial company" means-

(i) a hire-purchase finance company, that is to say, a company which carries on, as its principal business, hire-purchase transaction or the financing of such transactions; or

(ii) an investment company, that is to say, a company which carries on, as its principal business, the acquisition of

shares, stock, bonds, debentures, debenture stock, or securities issued by the Government or a local authority, or other marketable securities of a like nature; or

(iii) a housing finance company, that is to say, a company which carries on, as its principal business, the business of financing of acquisition or construction of houses, including acquisition or development of land in connection therewith;

(iv) a loan company, that is to say, a company [not being a company referred to in sub-clauses (i) to (iii)] which carries on, as its principal business, the business of providing finance, whether by making loans or advances or otherwise;

(v) a mutual benefit finance company, that is to say, a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act, 1956 (1 of 1956), to be a Nidhi or Mutual Benefit Society;

(vi) a miscellaneous finance company, that is to say, a company which carries on exclusively, or almost exclusively, two or more classes of business referred to in the preceding sub-clauses."

6. On perusal of the aforesaid provisions, a very distinctive feature which is spelled out is that the provision is applicable to an assessee which is a company and is not a company which is a banking or a financial company. Secondly, it makes no distinction in its operation whether the expenditure incurred by way of interest in respect of any deposits received by the company is related to companys' directors, their relatives, shareholders or for that matter with any person. Identity of depositor is irrelevant except to the extent it may be spelled out from the explanation which defines the term 'banking company' and 'deposit'.

7. The word "deposit" has not been left to take its colour from the general law but has to be construed in

the context of the provision and the special meaning assigned to it, though, in our opinion, even alluding to the general meaning of 'deposit' in the context of the provision of sub-sec. (8) of sec. 40A, the current account of the nature with which we are concerned, would not make difference to the conclusion to which we reach. The word "deposit" has been defined to mean, "any deposit of money with, and includes any money borrowed by a company".

8. This is wide enough to obliterate distinction between deposit and loan that is generally kept in view in the context of determining when the same becomes payable. That is particularly with reference to finding out when the payment was due and computing period of limitation for filing a suit.

9. Without reference to the exclusion clauses (i) to (ix), the word "any" is indicative of the fact that within the ambit of word 'deposit' the distinction of various kinds of deposits had not been maintained but it encompasses within its operation all kinds of deposits of money of whatever nature they are and the fact that the term includes money borrowed as well, the distinction that exists between a deposit and a loan is also obliterated. As a matter of fact, except to the extent exclusion has been provided, the term 'deposit' has been used in its widest possible meaning.

10. In Black's Law Dictionary, 'deposit', in reference to deposit of money, has been defined to mean,

"the act of placing money in the custody of a bank or banker, for safety or convenience, to be withdrawn at the will of the depositor or under rules and regulations agreed on. Also, the money so deposited, or the credit which the depositor receives for it. Deposit, according to its commonly accepted and generally understood meaning among bankers and by the public, includes not only deposits payable on demand and subject to check, but deposits not subject to check, for which certificates, whether interest-bearing or not, may be issued, payable on demand, or on certain notice or at a fixed future time."

Pausing here, the above definition reveals that deposit of money in its simplest and commonest meaning is an act of placing money in custody of another whether for safety or convenience. The fact whether such money placed in custody of a company is payable by the custodian on

demand or on certain notice or on a fixed future date does not alter its character as a deposit, nor the fact whether it is interest bearing or not results in losing its character as a deposit. The fact whether it is a term deposit, whether it is payable on demand or on notice can have relevant bearing if a deposit is to be discerned from a loan for different purposes. As noticed above, for the purposes of sec. 40A(8), no distinction has been made in dealing with interest paid, whether money is termed as deposit in the sense that it is payable on demand or is in respect of money borrowed in the sense that the borrower has an obligation to find the creditor and make the payment without making a demand.

11. The characteristic that such type of accounts as the company was having with its directors, shareholders or other persons which are in question are like the current accounts of the bank is a pointer that had the company been a banking company or a financial company, the interest paid on such accounts if they are deposits, would not have fallen within the mischief of sec. 40A(8) but since such type of accounts are with a company other than banking company or a financial company, they would not be saved from the operation of the provision if otherwise they can be called as deposit while dealing with the bank.

12. With such a broad definition, if one looks at the exclusion clauses, one can discern that from the definition the exclusion is of such deposits or borrowings by the company which comes in the ordinary course of its business as the business proposition or administrative requirement of its management. Clauses (i) and (ii) refer to moneys received from the Central Government or any State Government or local authority or from any other source where the repayment of amount is guaranteed by the Central Government or the State Government, and from the government of a foreign State or from a citizen of a foreign State, or from any institution, association or body (whether incorporated or not) established outside India. Obviously, these receipts are not expected to be dehors the business requirement of the company. Clause (iii) speaks of a loan from a banking company or from a co-operative society engaged in carrying on the business of banking. Clause (iv) also relates to loan from any institution or body referred to in Tenth Schedule or such other institution or body as the Central Government may specify in this behalf by notification in Official Gazette. It also excludes from deposits or loan from any other company, amounts deposited by way of security deposit

from an employee or purchasing agent or selling agent in the course of or for the purpose of the business of the company or as advance against orders for supply of goods or for the rendering of any service. The fact that under clause (vii) advance received from any agent in the course of or for the purposes of any business of the company or as advance against orders for the supply of goods or for the rendering of any service as well as security in that connection have been excluded from the term deposit emphasises the nature of exclusion clauses. Clause (viii) is exclusion of interest paid on money received by way of subscription to share, stock, bond or debenture pending allotment of the said share, stock or debenture or by way of advance of any moneys uncalled or unpaid upon any shares in the company. That is to say, it relates to interest paid on money received by it as contribution to the share capital of the company and last exclusion is interest paid on money received by the company as a loan from any person where the loan is secured by creation of mortgage, charge or pledge of any assets of the company and the amount of the loan together with the amount of any other prior debt or loan secured by the creation of mortgage, charge or pledge of such assets does not exceed 75% of its market value on the date of creation of such mortgage, charge or pledge for the relevant loan.

13. Exclusion clauses being exception to main definition are exhaustive and therefore, in our opinion, the conclusion is inescapable that any interest paid on any money received by the company other than a banking company or a financial company which does not fall in any of the exceptions contained in clauses (i) to (viii) of Explanation (b) of sec. 40A(8), the interest payable on such receipts and its deduction, which is an allowable expenditure, is governed by sec. 40A(8) during its operation.

14. We are fortified in our above conclusion by decision of the Bombay High Court in CIT v. Jhaveri Bros. and Co. Pvt. Ltd., 214 ITR 374 and a decision of the Madras High Court in CIT v. Khivaraj Motors Ltd., 227 ITR 473. Like question, as has been raised before us, was before the Bombay High Court in Jhaveri Brothers' case (supra) where amounts standing to credit of directors, shareholders and their family members in current account of company against which they were enjoying withdrawal facilities, the Tribunal held, like in the present case, such credit balances do not fall within the purview of deposit. The court said, on perusal of sec. 40A(8) of the Act and the definition of

the term 'deposit contained in clause (b) of the explanation thereto,

"we find it difficult to hold that the amounts belonging to the directors, their families and friends, lying in deposit with the assessee company will cease to be "deposits" merely because they were held by the company in current accounts. The term "deposit" has been defined in clause (b) of the Explanation to mean "any deposit of money with a company". This definition is couched very widely which is evident from the word "any" that precedes "deposit". We fail to understand how the tenure or nature of the deposits is relevant in finding out whether it is a deposit or not. In our opinion, the nature of deposit, viz., fixed deposit, call deposit, deposit in current account or savings account, is immaterial and irrelevant for determining whether it is a "deposit" within the meaning of sec. 40A(8) of the Act or not. The decisive factor is the true relationship between the assessee-company and its creditors.... These amounts were used by the assessee-company for its own business and it is on that account that interest paid by the assessee-company to such account holders on the amounts belonging to them and lying with the assessee was claimed as a deduction in the computation of its income. In such a situation, the amounts in question cannot be said to be anything else than "deposits".....

15. The Madras High Court in *Khivaraaj Motors (supra)* following a decision of the Rajasthan High Court in *CIT v. Gandhi Metals Mills (P.) Ltd.*, 200 ITR 252, Bombay High Court in *CIT v. Jhaveri Bros and Co. Pvt. Ltd.* 214 ITR 374, and Calcutta High Court in *Daga and Co. P. Ltd. v. CIT*, 227 ITR 480, (as appendices to the aforesaid Madras High Court judgment), held that the Tribunal was not correct when it came to the conclusion that sec. 40A(8) is not applicable to the facts of the case. From the reading of the two orders, it appears that the Madras case resulted in reversing decision of the Madras Bench of the Tribunal on which Income Tax Appellate Tribunal, while deciding the appeal of appellant under consideration, has relied.

16. In *Daga and Co. (P.) Ltd.* case (*supra*), the contention of the assessee was that the interest was paid on the current account of the directors of the company

and their relatives and friends. Such payment does not fall within the mischief of sec. 40A(8) of the Act. This was founded on the decision of the Madras Bench of the Tribunal in ITA Nos. 444 to 446 of 1981. S.C. Sen, J.(as His Lordship then was) speaking for the court said,

"A minute analysis of section 40A(8) and the meaning of "deposit" shows that interest paid on any deposit or loan except those enumerated in Explanation (b) comes within the restrictions placed by the section. "Deposit" has been defined as any deposit of money with the company and it also includes any money borrowed by the company. Thus, 'deposit' has a wide meaning and it takes into its amplitude any money received by the company as deposit or loan. It does not make any any exception of the directors, their relatives and friends as the creditors. However, the meaning of 'deposit' cannot be extended to any such transaction which is neither deposit nor loan, e.g., if any businessman or director has many dealings with the company in the course of business of the company and on that account if interest has been paid, it does not come within section 40A(8) of the Act. In this sense as we understand it has been held by the Benches of the Tribunal at Madras and Bombay that interest paid on current accounts is entitled to be deducted in full. The orders of the two Benches of the Tribunal cannot be spelled out to mean that the interest paid on the deposits to the directors of the company and their relatives and friends is allowable in full. Those two orders make a distinction between deposits and current accounts. Such distinction cannot be made to restrict to the directors of the company and their relatives and friends. Interest paid to any person is entitled to be deducted in full if it is paid on a current account and it does not fall within the meaning of deposit."

To the same effect is the decision of the Rajasthan High Court in Gandhi Metals Mills (supra).

17. A discordant note was struck by Madhya Pradesh High Court in CIT v. Kalani Asbestos (P.) Ltd., 200 ITR 55. On perusal of the decision, we find that though the court has said the tribunal was right in holding that disallowance under the provisions of sec. 40A(8) was not called for in respect of interest paid to the directors and shareholders on their current account, we do not find

any discussion or reasons in support of this conclusion. In view of detailed analysis of the provision, and the conclusion to which we have reached, we regret our inability to persuade ourselves to agree with the view expressed in Kalani Asbestos case (supra).

18. As a result, we answer the question referred to us in negative, that is to say, in favour of the Revenue and against the Assessee.

The assessee has not appeared in spite of service.

There shall be no order as to costs.

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